



Minutes of the Advisory Panel to DEFAC
Blue Ball Barn at Alapocas Run State Park – September 14, 2017

Attendance:	Chairperson, Mr. Michael Houghton			P
K. Lewis	A	H. McDowell		P
E. Ratledge	P	Q. Johnson		P
K. Simpler	P	M. Ramone		P
J. Bullock	P	A. DelCollo		P
R. Geisenberger	P	R. Johnson		P
M. Jackson	P	S. Malfitano		P
M. Morton	P	D. Smits		P

Support and Staff Present:

A. Loiaconi, A. Aka, B. Peterson, R. Goldsmith, J. Johnstone, N. Roby, D. Roose, S. Bailey, A. Jenkins, B. Scoglietti, S. Scola, D. Burris, B. Fahey

Members of the Public:

P. Morrill, B. Doolittle

1. Call to Order

Mr. Houghton called the meeting to order.

2. Introduction

Mr. Houghton and members introduced themselves. During introductions, Representative Johnson discussed the previous work done by the Revenue Council, and voiced displeasure in not being able to get more of the Council's recommendations implemented in the last legislative session. He finished by saying he hopes there will be a co-sponsored piece of legislation as a result of the Advisory Panel.

Mr. Houghton then spoke about how this Advisory Panel is a continuation of the process started years ago, and that consensus needs to be built around the issue, solutions to the issue, and a path forward. Mr. Houghton briefly walked through HJR 8, mentioning that expenditure growth has been/is exceeding revenue growth in the recent past, and that healthcare and education are among the groups driving a large portion of the expenditure growth. He mentioned the charge of the commission, including the requirement to address "the need for reasonable restrictions on the use of budget surpluses...to control the expansion of expenditures over the long term," and concluded with the sentiment that the Advisory Panel has a broad mandate but if it tries to do too much, it will achieve nothing at all.

Secretary Geisenberger had staff and members of the public introduce themselves, and mentioned that Department of Finance and Office of the State Treasurer staff could assist with questions and research moving forward.

3. Presentations

Mr. Jamie Johnstone, Economic/Fiscal Analyst with the Department of Finance, made a presentation covering existing fiscal controls, revenue volatility, and potential reforms, including the recommendations of the 2015 DEFAC Advisory Council regarding tax base broadening. Mr. Houghton asked why the Council on Revenues didn't make recommendations around fiscal controls and budget smoothing. Mr. Johnstone answered that the Council had a broad consensus around needing the measures but not the detail about how to proceed. Treasurer Simpler replied the Council also thought they may be outside their stated mandate and were short on time.

Senator McDowell asked whether a two year budget would take a portion of the volatility out and wanted to know how many states are on a two year budget. He made note that the recent revenue peaks and valleys were exactly two years apart. Senator McDowell mentioned that in his decades of service the General Assembly has always produced a balance budget and never used the rainy day fund, and that the value of the rainy day fund is lost once it is used because it has psychological meaning. He said he hears the other side of the argument when he meets constituents who are angry that cuts are being made when there is over \$200 million available to be used.

Mr. Houghton remarked that the rainy day fund, and its non-use, is a credit enhancement device, and may be the main reason Delaware has maintained a Triple-A rating. Secretary Geisenberger said he believed drawing down a rainy day fund is not an issue so long as you have a plan to restore the balance, and that the current requirements for withdrawal from the rainy day fund are ambiguous as to what it can be used for and when it can be drawn upon.

Senator DelCollo brought up that Delaware has strict voting requirements regarding new taxes and fees that contributed to our current situation and wanted to know if that should be considered moving forward. Secretary Geisenberger replied that it isn't considered a fiscal control to require a three-fifths vote; that is actually frowned upon by the rating agencies because it creates a higher requirement to solve any budgetary issues on the revenue side.

Senator McDowell then mentioned the Kiplinger report for state to state tax comparisons based on everything in a state after the federal tax obligations are met. He stated in their 2015 report Delaware had the lowest taxes in the nation.

Treasurer Simpler commented that getting all the data points out like those Senator McDowell mentioned are paramount to this process. He then called it a Delaware paradox where a state with one of the lowest tax burdens has one of the highest spending rates per capita of state and local spending when compared to peers. Treasurer Simpler also hoped they could build consensus around what a sustainable growth rate of the revenue portfolio could be over the long-term.

Treasurer Simpler introduced the team from Pew, giving some background about their non-partisan, non-profit work on budget stabilization funds and fiscal controls. Mr. Houghton mentioned to the group that Pew works for free, and reiterated their non-partisan standing.

Stephen Bailey and Brian Peterson, Associate Manager and Senior Associate from The Pew Charitable Trusts, gave a presentation on the nature of Pew's work with states, a broad overview of state revenue volatility, and specific examples of the tools states are using to address revenue volatility and associated budget issues.

Mr. Ratledge made the point that disparate growth rates for revenues and expenditures create a systemic problem—structural deficits—that is a separate issue. Discussion followed about the distinctions between and relationships of revenue volatility and structural deficits, and changes states have made to budget processes and reserve fund requirements as a result of the Great Recession.

4. General Discussion

Treasurer Simpler observed that our revenues follow the business cycle, and Delaware has very few countercyclical revenues to cushion the downturns. Revenue volatility makes it difficult to discern structural issues. In addition, the requirement to pay back to the reserve account the year after a withdrawal makes the issue worse, and is one reason we have never used our rainy day fund—it has to be large enough to grapple with a multiyear recession, and it can gradually be built back up when things get better.

Secretary Bullock said the difficulty is there are many people thinking this group is going to solve what is not a cyclical issue but a structural one; he would vote to start a new fund today, but unless the structural issue is addressed, it doesn't solve the problem, it only mitigates it.

Treasurer Simpler replied that this Council has two mandates: fiscal controls, and the stabilization fund. The question is if the dialogue around the fiscal control, or the sustainable rate with which we can grow the budget over time, can help us tackle the growth trend reality and open the conversation to the structural issues of healthcare, education, etc.

There followed a discussion regarding the recurring budget issues and pressures the State has faced over the last several decades with specific examples including the process and debate related to the fiscal year 2018 budget, policy changes made in response to those challenges, and the various other efforts made to study and address the issues from both the revenue side and the expenditure side.

Senator McDowell stated he believes a stabilization fund is worth looking at but he also wants to know if Pew has any information about the effect of two-year budget cycles.

Mr. Houghton summarized the discussion, saying that the politics are such that budget controls will likely have to go hand-in-hand with efforts to reduce revenue volatility, but that if the problem is not

addressed, we may continue on a path where June budget debates continue to go to—or beyond—the last minute.

Treasurer Simpler made the point the Panel should not confuse economic base with tax. He went on to say that the base was sound with stable growth each year, noting it was not extremely high growth—the economic measures of personal income, base not tax, Gross State Product, etc. are growing at roughly 3% each year. There was some question around the table if that was true. Treasurer Simpler asked Mr. Johnstone to pull the data for review.

Treasurer Simpler continued that the underlying means of the State do not show us as resource poor, but how we choose to tap them has become problematic. Secretary Bullock agreed with that statement adding that it has caused an imbalance over time. He went on to say the Franchise Tax and Unclaimed Property tax combined make up nearly \$2 billion of revenue for the state. Roughly half of the operating budget is paid for by corporations. Mr. Houghton agreed.

Secretary Bullock continued that he thinks corporations could pay more and the tax itself wasn't the issue, but that the current balance is unhealthy over the long-term.

Treasurer Simpler said he calls that our “means” and that our “means” are not going negative.

Secretary Bullock then mentioned the Revenue Council talking about a statewide property tax helping to solve the issue but that it is just not easy to do.

Treasurer Simpler said the things we are talking about can facilitate that dialogue. When looking at “needs,” the things that drive our service demands like CPI and population are growing at about the exact same rate as revenue bases. The problem is we are allowed to chase economic cycles. If the group can imagine a world where we no longer get 9% revenue growth followed by 6% and then revenue declines, but instead had 3% growth in perpetuity, it's a world where we could start the budget process on January first and know exactly how much money we have.

Senator McDowell responded that there is a great staff to support the Joint Finance Committee (JFC), but the estimates from DEFAC are late, the last being June 20th. He then requested to get the estimates earlier in the year, and have it still be accurate, to help the process.

Mr. Houghton replied that the timing of the estimates has a lot to do with collection periods, which could be reconsidered. He asked the group if they believe it is not fiscally prudent to have 40-50% of the revenue portfolio coming from corporate-related taxes, exported taxes and unclaimed property. Mr. Houghton noted that escheat is slipping away and it will not be what it is today 3-10 years from now. He asked again if everyone agrees the group should be looking at more stable revenue sources.

Representative Johnson agreed that making unpredictable sources more predictable is ideal, especially after the work on the Revenue Council. He suggested designating Unclaimed Property revenue to the stabilization fund and creating a statewide property tax to replace the revenue, which would remove a

tremendous amount of volatility from the General Fund. He also agreed with Mr. Houghton's previous remarks about finding the political will to get something done.

Senator DelCollo said it's difficult because there is very little confidence among constituents that the state is spending the money wisely. He said that it is reflected in the whereas portions of HJR 8 that value return is important. In fact, the final whereas says cost containment strategies which gets into more of the fiscal control than just the budget smoothing. He finished by stating part of the reason the political will is not there is because there is a lack of confidence. Mr. Houghton agreed that the politics are difficult

Representative Ramone said the state has lost the ability to attract people with jobs—people are coming now because of the low taxes. If we get rid of that we will be in more trouble. He requested the average revenue growth of each state over the last five years as 3% was continually mentioned for Delaware. He wanted to know if we have a growth problem or a spending problem. He then made reference to Delaware's spend it or lose it mentality as being problematic and reiterated that some of the whereas clauses empower that discussion.

Representative Ramone discussed in detail the causes of the State's budget problems, including the number of school districts and lack of property reassessments. He agreed that designating revenue for a stabilization account was a good idea, but that would create a larger budget deficit without other changes; he thought these were the problems the group was intended to resolve.

Mr. Houghton then commented that he did not disagree with Representative Ramone, but reiterated that he is an advocate for the possible—what is the deal that could that could collect sufficient political and policy consensus? If the deal is one that allows the Administration to spend money hand over fist, that won't be a deal at all, so some type of breaking mechanism or assurance that monies generated over a certain percentage would be dealt with a certain way should be discussed.

Representative Ramone replied he agrees with Mr. Houghton's comments in general. There are opportunities to address some of those topics that maybe weren't so popular in the past in a comprehensive way. Representative Johnson then stated that if there is no cost containment discussion there will be no political agreement.

After some discussion of economic trends, Mr. Houghton invited Mr. Ratledge to make his presentation on Delaware's long-term demographic trends at a future meeting.

Secretary Bullock suggested we also take a look at expenditures—it is important to know where exactly we spend the money to allow people to make the decisions about where we want to spend less. Senator DelCollo then said the Government Accountability Act was passed with bipartisan support. Secretary Geisenberger commented that the Government Efficiency and Accountability Review Board (GEAR) is taking a look at the Government Accountability Act. There are other groups working on developing a healthcare benchmark, school district consolidation, and so on, and that this group should focus on the issues of revenue volatility and the structural deficit.

Senator DelCollo stated he applauds the work of the Governor with GEAR, but he is concerned that without looking at the fiscal control what accountability will remain. He did not believe the political support for large scale revenue changes as discussed by Mr. Houghton exists unless there is accountability.

Secretary Geisenberger replied for clarification that he doesn't want to duplicate efforts. Mr. Houghton said the group should not do the work of the other committees, but should be aware of what they are doing so it can be incorporated into the group's thinking.

5. Future Meeting Dates and Topics

Mr. Houghton asked for input so he could set future meeting agendas, and that meeting dates would be sent out shortly.

6. Public Comment

Mr. Houghton asked for public comment.

Mr. Doolittle, an advocate for children, stated he has 25 years of data on revenue, expenditures, and DEFAC practices that he is happy to share if needed. He continued that he has lots of suggestions but wanted to start with the "low-hanging fruit" which is really the budget smoothing. The fact that the State utilizes unencumbered funds as a source of revenue is very problematic and amplifies the available appropriation level variances by a factor of 2 at times. He stated that part of the problem last year, roughly \$162 million, was simply because the State uses unencumbered funds as revenue. That needs to be looked at seriously and decide if some of those dollars should be treated differently.

Mr. Doolittle continued with regards to the smoothing, the State has a Rainy Day Fund but it is not a Rainy Day Fund. It is a hurricane fund. It is an emergency fund and a misnomer. He thinks that has great value and should stay in place but he also thinks we should set up a countercyclical fund to flatten things out a little bit. Unencumbered funds would be a good place to draw some of those funds when it exceeds the 2%. There are years when the State is at 4.5%. It will help you weather the downturns at a substantial part of the budget if you are talking 10% to 15%.

Lastly, Mr. Doolittle said if you do flattening of volatility you will recognize structural deficits sooner.

7. Adjournment

The meeting was adjourned.